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International Economic & Energy Weekly

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3 July 1986

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As a result of strong pressure from Washington, several Asian LDCs are beginning to offer more protection for intellectual property rights (IPRs). In the future, the pace of reform may slow as harder problems, such as product patents, are tackled, and the regulations for administering and enforcing these laws are worked out. Moreover, once the US review of the Generalized System of Preferences (GSP) is completed, an important US bargaining chip will be removed. 25X1

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Perspective

The Philippine Economy: Pulling Up on Its Rural Bootstraps 25X1

President Aquino's economic advisers are weighing a commitment to rural development as the cornerstone of the new government's program for economic recovery. They realize that declining support for the Marcos government and the rapid escalation of the Communist insurgency after 1981 coincided with the sharp decline in rural incomes. In our judgment, Aquino's advisers believe that an effective counterinsurgency program requires a "decent" standard of living in the countryside, where 70 percent of the population resides and which contributes more than one-fourth of the national output. 25X1

In our view, a good case can be made for the rural strategy on the grounds that traditional development programs will not significantly improve the living standards of the average Filipino. Import-substitution policies of the Marcos government, for example, foisted high costs on manufacturers, discouraged agricultural export production, and created few industrial jobs. Moreover, Aquino's economic planners cannot count on sustaining growth simply by exporting unprocessed agricultural commodities or manufactured goods; commodity prices this year are at their lowest levels relative to those of manufactures since the 1930s, and most economists expect little improvement for at least the next few years. Furthermore, the low cost of Philippine labor is no longer sufficient by itself to ensure the competitiveness of manufactured goods because, for over a decade, new production technologies have lowered labor's share of total manufacturing costs. 25X1

Alternatively, by boosting rural output and incomes through improved rural infrastructure, agricultural extension services, and market-oriented pricing policies, the Philippines, we believe, could develop an internal market capable of supporting economic growth while avoiding the inefficiencies of import-substitution policies. A necessary component of this strategy would be an exchange rate depreciation that directly raises incomes for rural exporters and makes it profitable to invest in agribusiness enterprises. We believe the peso's nearly 50-percent devaluation since late 1983, for example, helped boost agricultural output by nearly 5 percent during 1984-85—in contrast to a 10-percent decline in the economy's overall production. 25X1

Aquino's government, nevertheless, faces numerous political hurdles in carrying out a rural-focused development strategy. Urban interest groups—which were responsible for ousting Marcos—are likely to oppose exchange rate, tariff, pricing, and tax policies designed to boost the rural economy if they believe those policies would hurt urban industries or raise consumer prices. Furthermore, Aquino's economic team—comprising businessmen, bankers, and academics with little understanding of small-scale agriculture—may not be sufficiently committed to rural development to overcome lobbying by urban interest groups. Complicating the picture is the time it takes for rural development to succeed under even the best of circumstances, and Aquino has said publicly that she has to deliver tangible benefits quickly in the countryside. [redacted] 25X1

Manila's projected large budget deficit this year—probably more than 4 percent of national output—will also restrict the scope of the government's rural development effort. A high-impact rural development program requires large outlays for roads, postharvest food storage, irrigation, and a revitalized agriculture extension service. In addition, improving farmers' welfare will require costly improvements in both the civilian and military counterinsurgency programs to increase rural security. [redacted] 25X1

Such budget constraints seem certain to make financial aid a contentious and troublesome issue between Manila and its aid donors. For example, during a May meeting in Tokyo, Manila pressed donors with unrealistic expectations for additional assistance, while resisting politically unpopular economic policy reforms such as new taxes and lower import tariffs. Under these circumstances, Manila may well use the prospect of renegotiation of the Military Bases Agreement with the United States, which is likely to begin in 1988, as leverage to obtain more aid now from Washington. [redacted] 25X1

[redacted] 25X1

The Philippines: Aquino's Critical Challenge— Reviving the Economy

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President Aquino recognizes that her political future depends primarily on reviving the troubled economy, and, in some respects, her government is off to a good start. If investor confidence continues to firm, the economy could grow by 1.6 percent this year and by almost 6 percent next year, according to our econometric simulations. Nevertheless, maintaining the economic recovery beyond 1987—and, in turn, undercutting the Communist insurgency—will require major economic reforms in agriculture, government finance, the banking system, and trade policy. Conservative-minded advisers, such as Finance Minister Ongpin, will face considerable opposition to these reforms from populists and nationalists in Aquino's Cabinet.

Aquino's Economic Opportunity

Despite the fact that the Philippine economy has been ravaged over the past decade, Aquino comes to power at an opportune time in the business cycle. According to our index of leading economic indicators,[1] the economy bottomed out late last year from the recession that began in 1983 and is now probably growing slightly—a development that preliminary Philippine Government estimates of GNP for the first quarter of this year confirm. In addition, inflation is low—prices actually fell in April—interest rates are declining, and foreign exchange reserves have increased by nearly $800 million to $1.7 billion since Aquino took office.

Continued economic recovery in the short term depends heavily on private-sector confidence as Manila finds it increasingly difficult to use more traditional fiscal and monetary tools to prime the economy. A $1.9 billion projected budget deficit for this year—primarily the result of preelection spending by Marcos—will, in our view, force Manila to trim spending or raise taxes to reduce the deficit to a manageable level. In addition, the deficit is a major point of contention with the IMF in negotiations for a new standby credit agreement. Finally, export growth will provide little help to the economy; slower demand growth in the United States and Japan and low prices for the Philippines' leading commodity exports—coconuts and sugar—will probably keep overseas sales flat this year.

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For their part, domestic investors are responding enthusiastically to the change in government. Underlining this confidence, stock prices on the relatively small Philippine stock exchange have increased by almost 40 percent since Aquino took office and capital flight, which was rife in the last two years under Marcos, appears to have ended. If domestic business confidence continues to firm and the confidence of foreign investors strengthens, the economy will grow by about 1.6 percent this year and by almost 6 percent in 1987, according to our econometric model.

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On the financial side, an improved foreign payments position over the next two years hinges on foreign creditors agreeing to reschedule principal payments falling due in 1987. Principal payments on the foreign debt are scheduled to jump by more than $1 billion next year because the 1985 rescheduling agreement included only debts maturing through the end of 1986. A rescheduling of both public and private debt will allow Manila to maintain foreign exchange reserves at relatively comfortable levels of $2-3 billion over the next few years with little additional external financing. Moreover, the Philippines' external finances will probably improve this year because of the dramatic

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[1] The index tracks the Philippine economy on a monthly basis and allows us to anticipate by three to four months major turns in the economy. The index follows money, trade, profit expectations, government revenues, and manufacturing employment and production costs.

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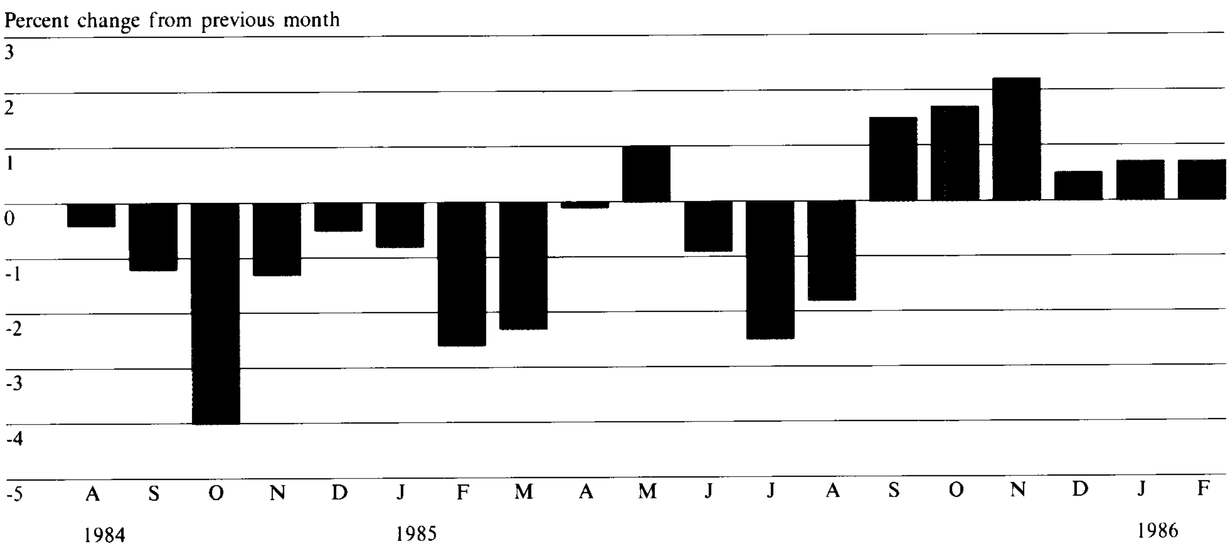
The Philippines: Index of Leading Economic Indicators, 1984-86



[redacted] 25X1

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falls in world oil prices and international interest rates that together will save the government nearly $1 billion in foreign exchange outlays. [redacted] 25X1

There is considerable downside risk in the outlook, however. Continued business confidence is not assured, and foreign investors are especially cautious. [redacted] they are looking for at least six months of economic and political improvement before risking investments of new money. In particular, Japanese businessmen—and the Japanese Ministry of Finance—are worried about the strength and longevity of the Aquino government, [redacted] 25X1

A Reform Agenda: Core Issues

In our judgment, the Philippines' tenuous economic recovery will run out of steam unless further policy adjustments are made to deal with major problem areas. [redacted] 25X1

Agricultural Productivity. Agriculture, which generates more than one-fourth of national output and provides livelihood for 70 percent of the population, was severely damaged under the Marcos government by monopolies, misdirected investment, and an overvalued exchange rate. Freeing agriculture from the control of marketing monopolies is a major first step to increase rural incomes. We estimate, for example, that the lifting in March 1986 of the four-year ban on the export of copra—the oil-bearing meat of the coconut—will increase domestic copra prices by at least 50 percent over the next year as oil mills and exporters compete for domestic copra. In addition, allowing the peso to depreciate further would boost exporters' incomes and help direct investment into more profitable rural ventures, such as food-processing industries.[2]

[redacted] 25X1

[2] Although the Philippine peso has been devalued by 50 percent against the US dollar since 1983, we calculate that, at 20.5 pesos per dollar in May 1986, the exchange rate remains overvalued by as much as 25 percent. [redacted] 25X1

The Philippines: Balance of Payments, 1981-86

Million US $

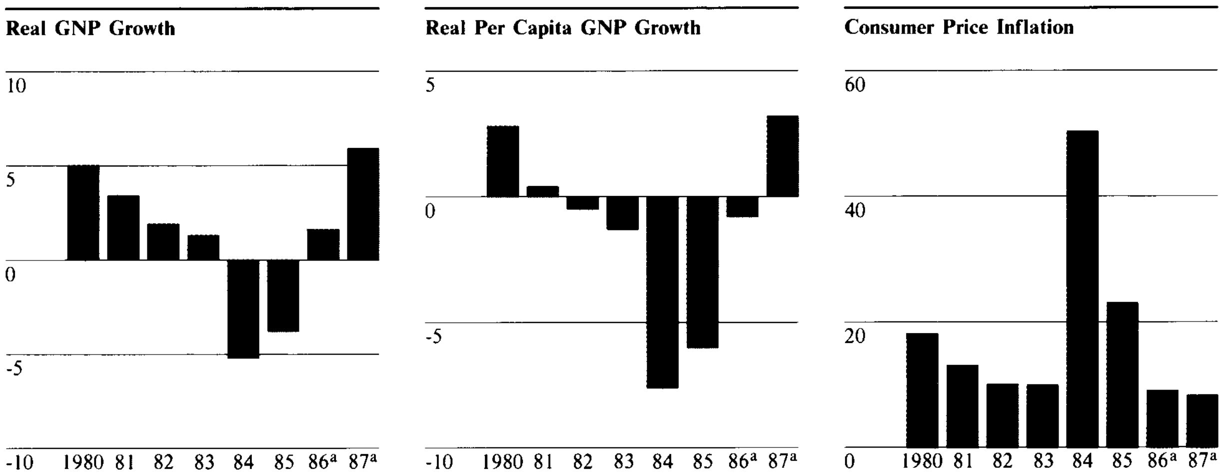
	1981	1982	1983	1984	1985	1986 [a]
Current account	−2,096	−3,212	−2,751	−1,253	105	661
Trade balance	−2,224	−2,646	−2,485	−679	−486	−305
Merchandise exports	5,772	5,021	5,005	5,391	4,628	4,555
Coconut oil, crude and refined	533	401	516	580	347	350
Sugar, raw and refined	567	416	299	246	169	125
Copper, concentrates	429	312	249	115	84	90
Electronics products	838	1,000	1,053	1,329	1,056	1,100
Garments	616	539	545	603	622	650
Merchandise imports	7,946	7,667	7,490	6,070	5,114	4,860
Crude petroleum	2,081	1,784	1,741	1,472	1,278	1,000
Service exports	2,861	2,983	3,127	2,626	3,284	3,440
Service imports	3,205	4,023	3,865	3,586	3,155	2,940
Interest payments	1,374	1,911	1,929	2,380	2,125	1,990
Private transfers, net	325	322	237	118	140	144
Official transfers, net	147	152	235	268	322	322
Capital account	**2,009**	**2,570**	**−622**	**998**	**1,986**	**316**
Direct investment, net	172	16	105	−6	−7	40
Portfolio investment, net	3	1	7	−3	−4	38
Other long-term capital, net	1,131	1,548	1,044	257	3,052	50
Other short-term capital, net	712	1,281	−1,550	502	−1,728	−62
Errors and omissions	−490	−364	−356	100	540	0
Other	481	88	128	148	133	250
Overall balance	**−87**	**−642**	**−3,373**	**−255**	**2,091**	**977**
Foreign exchange reserves (end of year)	**2,066**	**888**	**747**	**602**	**615**	**2,400**

[a] Estimated.

[redacted] 25X1

The Government Budget. Manila ran annual budget deficits since the mid-1970s, half of which were financed by overseas loans. A major source of the budget problem is inefficiency in the domestic tax system, including a narrow tax base and poor collection. Import duties and export taxes, which account for almost 35 percent of revenues, have been sharply reduced as foreign trade declined over the past few years. At the same time, money-losing government corporations are a major drain on the budget from the spending side, costing Manila almost $1 billion a year in operating subsidies. Narrowing the deficit would reduce the country's reliance on foreign capital and spur domestic investment by freeing savings for private use. Returning ailing corporations to the private sector would slash government expenditures, but, given their weak balance sheets, Manila may find it difficult to find buyers. The government, for example, believes that the private sector is interested in purchasing only five of the 35 companies held under the National Development Corporation—a government holding company. [redacted] 25X1

The Philippines: Selected Economic Indicators, 1980-87



Note scale change.
[a] Projection.

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Financial System. The Philippine banking system is undercapitalized and has been threatened over the last several years by failing public banks and deteriorating loan portfolios. Banks are stuck with nearly $5 billion in problem loans primarily because they financed the government's acquisition of financially distressed firms, many of which were purchased from political allies of Marcos.

Moves to shore up the financial system would include merging some private banks, as well as limiting new lending by government financial institutions and transferring some of their functions to the private sector. A strengthened banking system would, in our view, more effectively channel savings to high-return investment projects and reduce the country's reliance on foreign borrowing by encouraging domestic saving.

International Competitiveness. For the most part, Philippine manufacturing firms are uncompetitive in world markets. Philippine industry—operating within an extensive network of tariff and nontariff barriers—has had the lowest export growth among developing countries in East Asia over the last several years. High tariffs have insulated domestic firms from tough import competition and, as a result, have left much of the economy plagued with high-cost, inefficient production. In addition, an overvalued exchange rate—designed to benefit politically active urban consumers under Marcos—discourages exports, encourages imports, and directs investment to enterprises that can only sell to the domestic market. Under pressure from Manila's financial creditors, limited progress was

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The Philippines: Key Economic Issues, Political Pressures, and Likely Outcomes, 1986

Issues	Politics	Likely Outcome
Foreign debt	Leftists and nationalists will push hard for radical approach, but Finance Minister Ongpin strongly opposes such moves. He will make this a key fight if necessary.	Radical approach unlikely, particularly if IMF allows more expansionary policy. Will probably follow lead of other LDC debtors in negotiations with commercial banks.
Rural development	Leftists emphasize income redistribution and champion sweeping land reform, subsidized interest rates for farmers, and strict price controls. Ongpin, however, promotes private-sector initiatives and channeling credit to rural areas.	A modest land reform program will begin, support prices for agricultural goods are likely, and new rural lending institutions will be established. Despite considerable rhetoric, however, Manila will be slow to undertake comprehensive rural development.
Agricultural monopolies	Nearly all coalition members favor dismantling the monopolies.	Moves to dismantle the monopolies have begun, including allowing the export of copra.
Government corporations	Ongpin in favor of privatizing numerous government corporations. Nationalists and small businessmen will argue against allowing overseas companies to purchase these firms.	Privatization will probably move ahead but with restrictions on foreign ownership. Biggest problem will be finding domestic buyers for the troubled firms.
Budget deficit	Except for economic technocrats, almost universal opposition to tax reform that would result in higher taxes. Ongpin favors reducing deficit with spending cuts, but populists will push expensive social programs.	Even with the privatization of government corporations, Manila will have a difficult time reducing the deficit without higher taxes. Will be contentious issue in IMF negotiations.
Exchange rate	Ongpin, technocrats, and export-oriented businesses will push for a freely floating rate, which will probably result in a depreciation of the peso as the economy strengthens. Populists in the Cabinet, however, want to avoid the politically costly inflation that would result.	A managed float with slight depreciation.
Labor disputes	Could be an area of severe disagreement among coalition members—particularly between left-leaning Labor Minister Sanchez and the probable hardline approach of Defense Minister Enrile.	A stronger government mediation role is possible. Could also generate considerable political fallout.
Disposing of crony assets	Ongpin favors dumping the assets of Marcos's associates on the free market. Nationalists may argue that the government should retain them, while others—such as Jose Cojuangco and Vice President Laurel—would not object if they received some of the spoils.	If pre-martial-law ownership is clear, assets will probably be returned to original owner with substantial political benefits. Otherwise, most assets will probably be sold on the open market.
Banking system	Ongpin favors free market approach, but most other Cabinet members will oppose reforms if they result in large job losses.	Moderate level of reforms likely. Will help placate foreign creditors.
Foreign trade and investment	Technocrats and trade-oriented businesses favor more open environment, but populists in Cabinet are wary of increased competition. Heavy opposition from small businessmen and nationalists.	Moves to open the economy will be slow and will probably generate extensive public debate.

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made under the Marcos government in areas such as loosening foreign exchange regulations, but most barriers to trade remain. 25X1

Looking Ahead

Although most of Aquino's economic advisers—including Finance Minister Ongpin and Trade Minister Concepcion—support economic reform, progress will probably be slow in coming. Many of Aquino's closest advisers would prefer that the new government move in a populist direction, chiefly toward more social spending and continued protection of inefficient domestic industries and employment. Several important political constituencies—consumers, small businessmen, and organized labor—are likely to mount stiff resistance to tax, trade, foreign investment, and financial reforms because, despite the potential long-term benefits, these reforms entail short-term costs. 25X1

If Aquino indulges the populists, the economy could become her biggest liability, particularly because expectations for improvement among Filipinos are so high. Short-term economic recovery and a piecemeal approach to economic reforms, for example, will not be enough to provide the boost in rural living standards needed to undercut the Communist insurgency. Even if the economy grows by an average of 5 percent a year after 1987—a difficult task without major reforms—per capita income could not return to the 1981 peak until 1994. Without an improvement in the distribution of income, the Communists will continue to make political and military inroads in the countryside no matter how well the middle class in Manila is doing. 25X1

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Saudi Arabia–Kuwait: Budget Constraints Reducing Aid to Iraq [redacted]

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Saudi and Kuwaiti aid, which underwrites Iraq's war effort, probably will drop this year to about $1.6 billion—down from an estimated $2.5 billion last year—unless Riyadh and Kuwait substantially increase cash payments. Since the decline in oil prices and the Iranian capture of Al Faw, Iraq's need for financial aid has grown, but the economic constraints on Saudi Arabia and Kuwait have made them increasingly reluctant to bear any additional financial burden. Moreover, Tehran's willingness to take aggressive action against Iraq's aid donors has heightened the risks of continuing to support Baghdad. Even so, Saudi Arabia and Kuwait are still committed to supporting Baghdad and preventing an Iranian victory; they probably will continue to provide enough aid to prevent economic difficulties from threatening Iraq's ability to prosecute the war. [redacted]

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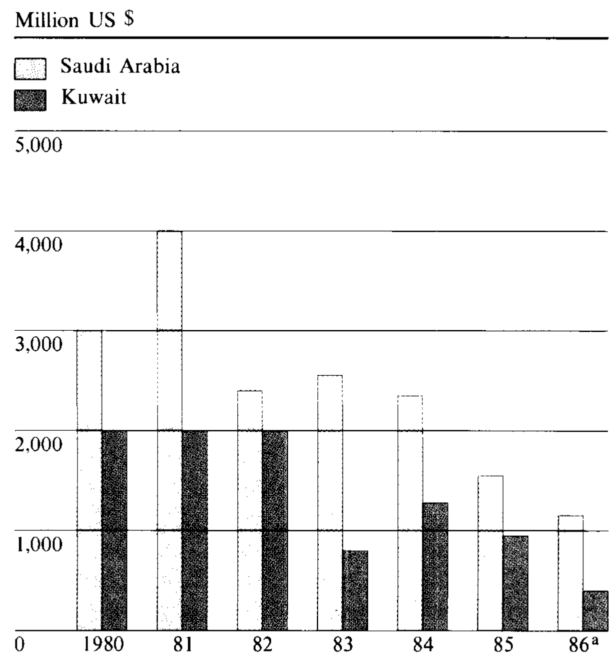
Saudi Arabia and Kuwait: Cash and Oil Aid to Iraq, 1980-86



[a] Projected aid based on total oil price and production levels so far this year. Assumes oil prices will increase slightly during the second half of 1986.

[redacted]

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Forms of Aid

Neutral Zone Oil Sales. The bulk of Saudi and Kuwaiti assistance to Iraq comes in the form of oil aid payments and probably will total $700 million this year. These payments are based on a 1983 agreement whereby Iraq receives annually the cash equivalent of 248,000 b/d of crude production from the Hut 1 and Al Khafji oilfields offshore from the Neutral Zone. Because the oil aid is based on volume, payments have declined substantially this year as oil prices fell. This loss in revenue has been compounded by the inability or unwillingness of the donors to market the agreed-upon amount of Neutral Zone oil—sales have averaged about 125,000 b/d during the first four months of this year. Baghdad is to repay Saudi Arabia and Kuwait for the Neutral Zone aid—without interest—in crude. These payments, however, which originally were to start in February 1985, have been rescheduled and are unlikely to be repaid in full. [redacted]

Saudi Arabia and Kuwait recently agreed to renew the Neutral Zone aid agreement, despite their own financial constraints. The original Neutral Zone agreement was to expire in January 1985 but was extended until February 1986. Riyadh and Kuwait then hoped that the completion of the Iraqi-Saudi Spurline (phase I), with the additional revenues it offered Iraq, would allow them to terminate the agreement. Instead, Saudi Arabia and Kuwait

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Saudi and Kuwaiti Direct Aid to Iraq, 1985-86 *Million US $*

	1985	1986
Total	**2,500**	**1,555**
Neutral Zone oil	1,900	700
Saudi oil	500	285 [a]
Cash payments	100	570 [b]

[a] Based on exports of 60,000 b/d.
[b] Observed payments to date.

[redacted]

agreed that the escalation in the Iran-Iraq war required a continuation of aid until an agreement between the combatants was reached, [redacted]

Saudi Oil Sales. Saudi Arabia continues to sell some of its own oil on Iraq's behalf. Last year these sales amounted to about 50,000 b/d but probably will increase this year to help offset the decline in Neutral Zone oil aid. A large portion of the sales probably is under an agreement in which the Soviet Union lifts Saudi oil and sells it to India, with the proceeds used to pay for Iraqi purchases of Soviet weapons. [redacted]

Cash Payments. Since the Iranian invasion of Al Faw in February, the Saudis and the Kuwaitis have made up for at least some of the shortfall in oil aid payments through direct cash transfers. We estimate Saudi payments have totaled about $520 million so far this year and probably were used to finance arms purchases. We believe Kuwait has given Iraq about $50 million with the promise of further payments to follow. [redacted]

Guarantees of Iraqi Financing. [redacted] Riyadh guaranteed payment of Iraqi letters of credit issued to finance the purchase of US military trucks and probably will do the same for the purchase of US cargo planes. We believe Saudi Arabia and Kuwait are likely to guarantee future Iraqi borrowing for the purchase of critical military supplies. [redacted]

Supply of Military Equipment. Saudi Arabia and Kuwait provide Baghdad with small amounts of munitions out of their own stocks, including cluster bombs and FROG missiles. [redacted] 25X1

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[redacted], both Saudi Arabia and Kuwait serve as transshipment points for Iraqi military and civilian supplies. [redacted] 25X1

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Export Pipelines. Although not direct aid to Iraq, Saudi Arabia allows Baghdad to export about 350,000 b/d through the Spurline-Petroline combination, which began operations last September. At an average price of $13 per barrel, this pipeline will provide Iraq with about $1.7 billion this year. Riyadh also has given final approval for the Iraqi-Saudi pipeline (phase II), which will cross Saudi Arabia and increase Iraq's oil export capacity through the Kingdom to about 1.6 million b/d by the end of 1989. [redacted]

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Growing Pressures

Although both Iraq and Iran face severe economic hardships in the months ahead, the decline in oil prices probably poses greater economic and political dangers for Baghdad than for Tehran. Oil revenues have declined dramatically because Baghdad is unable to raise oil exports significantly to offset lower prices. It remains dependent, however, on its oil revenues to finance imports—both military and civilian—and to meet payments on its large foreign debt. In addition, the Ba'th regime relies heavily on domestic spending to maintain popular support. [redacted]

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Baghdad will need sustained Saudi and Kuwaiti financial assistance to offset Iran's greater economic resilience and to bolster its beleaguered economy. Both Saudi Arabia and Kuwait face their own

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Iraqi-Saudi Petroleum Export Facilities

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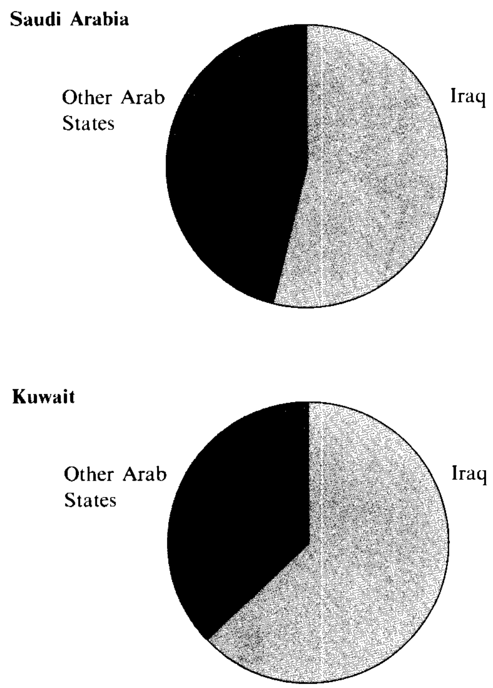
serious financial constraints, however, including budget cuts of unprecedented levels, and are showing signs of increasing weariness with large aid payments. The weak oil market and the donors' difficulties in marketing their own oil exports make them reluctant to sell large amounts of oil on Iraq's behalf. 25X1

Since the oil price decline and the Iranian invasion of Al Faw, financial and security concerns have multiplied for Saudi Arabia and Kuwait, as well as for Iraq. Tehran is becoming more agitated with Saudi Arabia and Kuwait for their financial support to Iraq because it believes that Riyadh's aggressive oil policy is directly responsible for the sharp drop in oil prices. Tehran also probably believes that the fall in prices puts it at a disadvantage with respect to Iraq, which can turn to Riyadh for help in offsetting its oil revenue losses. Iran has made its position clear by increasing attacks on Saudi oil tankers in the Persian Gulf and stating publicly that it cannot allow Saudi Arabia and Kuwait to continue financial support for Iraq. The attacks in June against Kuwaiti oil installations—probably by Iranian-backed terrorists—show Kuwait's vulnerability to subversion and magnify Kuwaiti fears, especially since the invasion of Al Faw, of Iranian designs on Iraq and the Gulf states. 25X1

Saudi Arabia and Kuwait: Aid to Iraq as a Share of Total Aid to Arab States

Percent



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Outlook

The Saudis and the Kuwaitis are committed to supporting Baghdad and to preventing an Iranian victory, but are unwilling to bear more of the financial burden than absolutely necessary. While they do not want to give the appearance of buckling under to Iranian pressure, they seek to avoid intentionally provoking Tehran. Even so, they probably will continue making substantial cash and oil aid payments to Baghdad. 25X1

If Saudi and Kuwaiti aid remains at current levels for the rest of the year, none of Iraq's $4 billion decline in oil revenues this year will be offset. As a result, Iraq would have to institute tougher austerity measures than those already in place and reduce imports by more than the one-third cut presently needed. In addition, Baghdad's lenders probably will further restrict trade credit, making foreign suppliers even more reluctant to do business with Iraq. Saudi Arabia and Kuwait probably will wait until Baghdad reschedules a large portion of its debt payments due later this year, slashes imports, and further reduces spending before giving Baghdad substantial cash payments not tied directly to military purchases. 25X1

The financial troubles of Saudi Arabia and Kuwait will push them to find the least costly way of aiding Iraq. The donors may broaden selective guarantees of Iraqi letters of credit and guarantee debt reschedulings. Less desirable options would be to sell additional oil on Iraq's behalf, allow more Iraqi oil through the Spurline-Petroline combination—current exports out of the Yanbu' al Bahr (Yanbu) terminal are about 200,000 b/d below the line's capacity—or allow Baghdad to export its oil through the second Saudi East-West Pipeline, expected to be completed early next year. Such sales would entail no cash outlay or strain to the donors' productive capacities, but allowing additional oil on the already glutted market probably would weaken prices further. In addition, Riyadh is unhappy about Iraqi price competition for oil sales at Yanbu. Saudi Arabia may also want to limit Iraqi oil exports through Yanbu because increased Iranian attacks on Saudi oil tankers in the Persian Gulf may require greater use of Riyadh's Red Sea facilities for its own oil exports. [redacted] 25X1

If Iran were to launch another major offensive against Iraq, Saudi Arabia and Kuwait probably would immediately channel additional cash to Baghdad. The Saudis and the Kuwaitis believe an Iranian victory would threaten their security and are committed to providing at least enough aid to prevent such a development. At the same time, however, an emboldened Iran would be likely to step up pressure on the donors to cut aid. Efforts by Saudi Arabia and Kuwait to mollify Tehran may lead them to miscalculate the minimum aid necessary to keep economic problems from threatening Iraqi political stability. [redacted] 25X1

[redacted] 25X1

Lebanon: Financing the Militias [redacted] 25X1

Lebanon's abysmal economy is driving much of the once-thriving Lebanese population to the brink of poverty and is impinging on the activities of the militias, which control most of the country. Rival militias are forced to seek funds more aggressively from local and foreign sources—a process that will almost certainly intensify factional struggles and violence. The militias have become more opportunistic in shifting alliances and patrons in order to survive. The result will be further destruction of what is left of the economy, and fading hope for any reunification. [redacted]

Militia Money Woes

All of the major militias have experienced shrinking revenues, especially from sources abroad, and have stepped up illegal activities to raise funds. The US Embassy in Beirut reports that Citibank in West Beirut was robbed almost weekly until it closed in late 1985. Muslim West Beirut recently suffered a two-week cutoff of petroleum deliveries after transport trucks refused to cross the Green Line because their cargoes were likely to be stolen. [redacted] some militias demand a special fee at the gas pumps, while others siphon off gasoline from motorists at checkpoints. [redacted]

The militias depend on financial support from residents of cities and villages in their respective cantons. The relative poverty of many rural areas, however, is pushing the militia leaders to turn to alternative sources for funds:

- In the southern Shia region, a fundraiser in each village collects money from most residents to support Amal, [redacted] Amal plans to build a container port in Beirut to gain customs fees.
- [redacted] Druze leader Jumblatt recently sent a letter to 2,000 Druze businessmen soliciting donations. When contributions are not forthcoming, strong-arm methods are used—16 Druze in one village were killed recently after refusing to pay monthly fees levied by the militias. 25X1

The Christian Lebanese Forces seek money from local merchants and other commercial establishments in East Beirut, levying a special tax on restaurants, petroleum, cinemas, and the Casino du Liban. 25X1 In addition, the Christian militia controls three illegal ports in the Christian enclave, and leases them to Christian entrepreneurs for large sums. We believe that revenues from these port operations dropped significantly after Syria tightened its border in January to stem illegal imports. The Lebanese Forces also have increased appeals to wealthy Christian expatriates in Western Europe, Africa, and the United States. [redacted] 25X1

Foreign Support Dwindling

We believe that funding from major supporters, Syria and Iran, as well as Libya, has generally declined over the past two years as the various patrons have suffered economic problems of their own. 25X1 25X1 As a result, the rival militias have sought multiple patrons—often with opposing aims—to finance militia activities and further their own interests. [redacted] 25X1

Syria gives financial and military support to several allies in Lebanon, including the Shia Amal organization, the Syrian Socialist National Party, the Ba'th Party, and the Lebanese Communist Party. Amal receives the lion's share, and there are reliable reports that Amal is now almost totally 25X1 25X1 25X1

Impact on the Economy

Although the militias ultimately represent a destructive element in the economy, financial support they receive from Iran, Syria, the PLO, and others actually provide a short-term economic boost. Lebanon's only bright spot in 1985 was a foreign payments surplus of $250 million, which is expected to increase in 1986. According to IMF data, "unidentified payments" inflows grew by 25 percent last year to $1.6 billion. Although a portion of this came from increased worker remittances as more Lebanese found work abroad, outside financial support for the militias probably accounted for much of the increase. Palestinian money flowed back into Lebanon beginning in early 1985 as expelled PLO fighters returned. The PLO has also substantially increased arms deliveries and financial support since its departure in 1983. [redacted] 25X1

In addition, the rival militias offer young, uneducated Lebanese men one of the few remaining job opportunities available in Lebanon. Unemployment is near 50 percent, and real annual per capita income has fallen to about $250 from $1,250 in 1975. Militia salaries and the money and goods acquired as "protection fees" from local businessmen appear increasingly attractive to many:

- [redacted] *in late 1985 Amal was paying new recruits monthly salaries of 1,200 to 1,500 pounds—about $75.* 25X1
- *Hizballah attempts to lure Amal militiamen with cash bonuses, higher salaries—about $200 per month—and housing for families of militiamen.* [redacted] 25X1

Nonetheless, on balance, militia violence and declining security have devastated the economy. Industrial activity is currently at 40 percent of capacity, and the chances of external financial support are slim. The US Embassy estimates price increases of 100 percent for the first half of this year, and the fall in the Lebanese pound—about 55 percent in 1986—has choked off vital consumer goods and raw materials. In addition, much of the skilled, professional class has finally opted to leave the country. [redacted] 25X1

dependent on Syria for military support. Nonetheless, [redacted] Amal still actively seeks funding from Shia expatriates in West Africa, Europe, and the United States. In fact, Amal leader Nabih Barri has proposed a Shia fundraising conference for Africa in July to attract funds from Lebanese expatriates in Sierra Leone, Ivory Coast, Liberia, and elsewhere. Amal, however, faces increasing competition for Shia African money from other militias, including Hizballah and the Syrian Socialist National Party. [redacted] 25X1

Iran's principal surrogate, Hizballah, is financially dependent on Tehran and is suffering a shortage of funds as the war with Iraq saps Tehran's resources. The Iranians typically funnel support through Damascus, but Tehran also provides funding through representatives in Beirut. Iran's financial support for the militia has fallen behind, and salaries for militiamen are several months in arrears. Hizballah faces the prospect of losing militiamen to rival groups. We believe that Hizballah now regularly receives military aid and large sums of cash from Arafat to help undermine Amal and Syrian interests in Lebanon. [redacted] 25X1

The Druze and their political party, the Progressive Socialist Party (PSP), are better organized than other Lebanese militias and are perhaps the most adept at attracting funds from the region's antagonists: 25X1

- [redacted] the Druze help pro-Arafat PLO fighters infiltrate in return for cash and despite Syrian objections. 25X1

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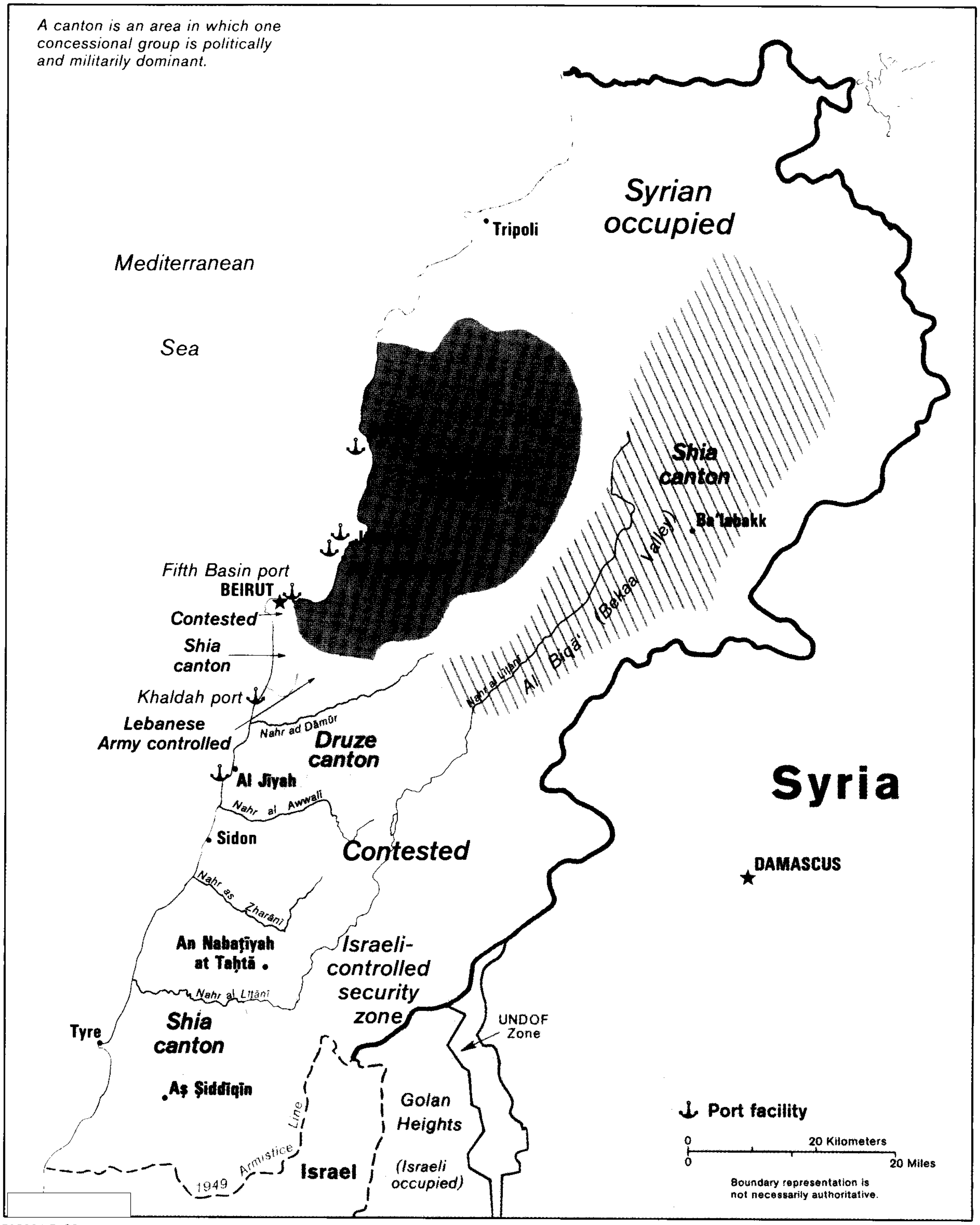
The Partition of Lebanon



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Lebanon: Militias and Their Sources of Support, 1986

Militia/Supporters	Comments
Druze	
USSR	Supplies arms, making Druze best-armed militia.
Syria	Transit point for Soviet arms.
Libya	Pays some salaries, allowed to maintain presence.
Israel	Limited intelligence contacts.
PLO	Pays for help infiltrating Fatah fighters through Khaldah.
Christian Lebanese Forces	
Domestic	Illegal ports, taxes, checkpoints.
Expatriates	Collect funds from Christians in Europe, Africa, and United States.
Israel	Intelligence contacts, past arms support.
Amal	
Syria	Military aid and salaries.
Expatriates	Collect funds from Shia businessmen in Middle East and West Africa.
Hizballah	
Iran	Principal donor, funnels funds through Embassy in Damascus.
PLO	Pays for arms and for help in infiltrating Fatah fighters.
Libya	Selected payments to individual members.
Syrian Socialist National Party	
Syria	Military aid
Libya	Mainly pays salaries.
Sunnis	
Saudi Arabia	Supports groups in Sidon and Beirut.
Libya	Aid to anti-Arafat groups.
PLO	Aid to counter Amal and other pro-Syrian elements.

[redacted] 25X1

- Meanwhile, the Druze port was also used in 1985 for periodic arms deliveries from Libya to major anti-Arafat factions in Lebanon.

- The Druze also may receive a payoff from the Christians for not interfering in illegal ports in East Beirut, according to recent Embassy reporting.

- In addition, [redacted] a Druze official in late May negotiated an agreement with Romania to ship fuel products to the PSP-controlled port of Al Jiyah in an effort to insulate themselves from periodic petroleum shortages. [redacted] 25X1

Outlook

The economic decline in Lebanon will almost certainly increase the militias' dependence on external sources, which will probably lead to even greater outside interference in Lebanon. Foreign players will probably take advantage of Lebanon's economic chaos to buy influence among rival factions. Continued militia violence will further destabilize the country and diminish the prospects for economic recovery and breaking the political stalemate. [redacted]

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25X1

The shortage of money both internally and abroad will intensify factional rivalries and help institutionalize the practice of "guns for hire." Competition for funds will encourage militias to serve several masters, further complicating the Lebanese scene. In addition to robbery and extortion, cash-starved militias may increasingly engage in drug trafficking. Both rival and allied militias will vie more fiercely for turf to compensate for shrinking revenues—a development that will push street fighting to dangerous new levels. 25X1

Finally, the pressures toward cantonization will increase with the decline in Lebanon's security situation. The growing violence will inhibit the human and commercial traffic between cantons. As rival groups seek to establish autonomous economic enclaves, the prospects for political reintegration become less likely. 25X1

25X1

Intellectual Property Rights: Enhanced Protection in Key Asian LDCs [redacted] 25X1

As a result of strong pressure from Washington, several Asian LDCs are beginning to offer more protection for intellectual property rights (IPRs). In particular, Taiwan, Singapore, South Korea, Malaysia, Indonesia, and Thailand are at various stages of improving their copyright, patent, or trademark laws. There are deficiencies with some of the new laws being considered, however, such as inadequate protection of pharmaceuticals. In the future, the pace of reform may slow as harder problems, such as product patents, are tackled, and the regulations for administering and enforcing these laws are worked out. Moreover, once the US review of the Generalized System of Preferences (GSP) is completed, an important US bargaining chip will be removed. [redacted] 25X1

Some Definitions

- ***Intellectual property*** *describes creative works, inventions, or scientific discoveries that have, in cases where necessary, been registered with government authorities for the sale or use by their owner.*

- *A* ***patent*** *is a government grant assuring an inventor the sole right to make, use, and sell an invention for a certain period of time.*

- *A* ***trademark*** *is a name, symbol, or other device identifying a product used to distinguish it from similar goods.*

- *A* ***copyright*** *protects literary, musical, artistic, and, more recently, computer software works against unauthorized copying or use.* [redacted] 25X1

A Costly, Pervasive Problem

Foreign infringement of patents, copyrights, and trademarks is eroding US competitiveness in world markets. This theft of US inventions, creative works, and scientific discoveries costs US companies an estimated $8-20 billion annually, [redacted]. Foreign counterfeiters are able to undercut US companies because they do not bear any of the R&D, advertising, or quality control expenses that legitimate businesses must incur. The infringement of IPRs extends to many industries and products including pharmaceuticals, chemicals, clothing, records, computer software, automobile parts, and videotapes. The problem is most troublesome in the Third World where intellectual property is not protected under the law, penalties are weak, or enforcement lax. [redacted] 25X1 25X1

Slow But Steady Progress

To redress this problem, Washington has exerted considerable pressure on a number of Asian LDCs through bilateral negotiations, the threat of curtailed GSP benefits, or, in the case of South Korea, unfair trade practice actions. This approach has resulted in slow but steady improvement in intellectual property protection:

- ***Taiwan*** has substantially increased the protection afforded to owners of intellectual property. In June 1985, a new copyright law was passed widening the scope—to include computer software and videotapes—and increasing the penalties for violators. Moreover, works will now be protected immediately after they are published in the United States. In addition, new patent and fair trade legislation is pending. 25X1

- In March 1986, ***Singapore*** submitted a copyright bill to parliament that stiffens penalties and doubles the period of protection from 25 to 50 years. Once the law is passed, it is likely that

Intellectual Property Rights in Key Asian LDCs [a]

	Copyright	Patent	Trademark	Comment
Indonesia	No foreign works are covered by the current law. Copyright infringement poses a particularly serious problem for the US recording industry.	Investors are allowed to file patent applications to create a priority claim once a patent law is passed. However, this procedure provides no immediate protection.	Not believed to be a serious problem at this time.	Earlier this month, a US industry group requested an unfair trade practice investigation over Indonesia's lack of copyright protection. It has been estimated that 40 million counterfeit tapes worth $75 million were manufactured in Indonesia in 1983.
Malaysia	The motion picture industry has complained of videocassette piracy as well as unauthorized public performances of copyrighted material. Lack of protection in Malaysia for computer software has led to pirating popular software programs and instruction manuals.	Malaysia enacted its patent law in 1983. The US pharmaceutical industry has complained that the 15-year protection period granted for its products is too short to recoup R&D costs. The law also lets the government expropriate a patented invention without compensation.	Trademark infringement has occurred in both the cosmetic and pharmaceutical industries.	Malaysia said it intends to join an international copyright convention. A new tougher copyright law was introduced to Malaysia's parliament in June.
Singapore	US nationals can obtain copyright protection only by publishing in Singapore or in a British Commonwealth country within 14 days after first publishing in the United States. To prevent importation of counterfeit works, copyright owners must register with an agency that has been abolished.	Not believed to be a serious problem at this time.	Not believed to be a serious problem at this time.	Singapore has taken some steps to increase intellectual property enforcement but faces significant local resistance from counterfeiters and retailers.
South Korea	South Korea provides no protection for foreign works or computer software in its copyright law.	South Korean laws deny patents on such items as new chemical substances and their uses, food, food products, and seeds. Process patents are ineffective and inadequate.	There is frequent pirating of US trademarks and brand names by South Korean companies. New guidelines abolishing the link between the use of trademarks and technology transfer agreements may limit the size of royalties paid to foreign trademark owners.	On 16 October 1985, an unfair trade practice case on South Korea's treatment of intellectual property rights was initiated. A resolution of the case is expected soon.
Taiwan	Requirements to supply Chinese-language dialogue for foreign films enable piracy to flourish. In addition, there is a relatively short 30-year term for copyright protection compared to international standards—50 years or author's life plus 50 years.	Taiwan limits its patent protection for chemicals and pharmaceuticals to process patents. The burden of proof in process patent cases lies with the patent holder. Microorganisms per se are not patentable. In addition, Taiwan's patent law makes it difficult to determine whether two inventions are identical.	Taiwan lacks both a defined discovery process and evidence code. This impedes successful trademark and patent infringement case protection.	The draft patent law would reverse the burden of proof. In addition, unfair competition resulting from false or misleading product packaging, labeling, or advertising is an IPR problem in Taiwan. Taipei submitted a fair trade law in June.

Intellectual Property Rights in Key Asian LDCs [a] (continued)

	Copyright	Patent	Trademark	Comment
Thailand	Bilateral copyright relations governed by a 1966 US-Thai treaty. A legal problem involving the treaty has made it impossible to actually secure direct copyright protection.	Thailand enacted a patent law in 1979. Pharmaceuticals, food products, and machinery are among the items excluded. The patentee must engage in local production using the patented process to obtain protection against patent-infringing imports.	Trademark copying or infringement by using slightly altered packaging is a problem in Thailand.	Resolution of the copyright problem is possible this year, but will require that the Thai Assembly pass an amendment to the existing copyright law.

[a] This table summarizes information derived from *The Annual Report on National Trade Estimates, 1985*, and followup cables from US Embassies.

25X1

Singapore will sign a bilateral treaty with the United States or join the Universal Copyright Convention (UCC). Moreover, enforcement against counterfeiters has been stepped up, and, according to the US Embassy, audiotape and computer software dealers have been disposing of their stocks of pirated products.

- ***South Korea*** is drafting new patent and copyright laws in response to a US trade investigation of South Korea's inadequate protection of US IPRs. South Korea plans to extend patent protection to pharmaceuticals and agricultural chemicals and join the UCC. Although some differences remain—such as translation rights, retroactive protection of US patents and copyrighted works, and a separate computer software bill—an agreement with the United States for improved protection is expected soon. In the trademark area, Seoul has issued new guidelines that abolish the requirement that the importation of trademarked goods must be connected to a technology transfer agreement.

- ***Malaysia*** introduced a new copyright law in June that, among many provisions, provides for protection of computer software. Moreover, various Malaysian officials have said Kuala Lumpur will join an international copyright convention. In addition, improvements have been made in the patent law.

- ***Thailand*** intends to grant the United States direct copyright protection, according to the US Embassy. In addition, a judicial council has ruled that computer software is protected under copyright law. Bangkok has also proposed some amendments to its existing trademark law that would extend coverage to well-known marks. Progress has been sidetracked, however, since the dissolution of the parliament in May.

- ***Indonesia*** is slowly becoming more aware of the need to enhance its protection of IPRs. Following his recent meeting with President Reagan, President Soeharto instructed his ministers to accommodate US interests, according to the US Embassy. A draft patent law is expected to be submitted to parliament in the coming months and probably will be enacted by yearend. In addition, the Indonesian Trade Minister said Jakarta may be willing to pursue a bilateral copyright treaty with the United States, according to the US Embassy.

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Despite this progress, many problems remain:

- Indonesia's draft patent law does not provide adequate protection to pharmaceuticals, chemicals, food, and beverages—deterring US companies from investing in these sectors.

- In Singapore, the copyright bill does not provide retroactive protection for US works.

- Instead of amending its copyright law, South Korea wants a separate computer software protection bill that probably would offer weaker protection.

- Bangkok is resisting any changes to its patent law that would include protection of pharmaceuticals—infringement cost one US pharmaceutical company an estimated $42 million in 1984, according to corporate records. 25X1

Outlook

Asian countries will continue to upgrade their protection of IPRs in the face of sustained pressure from Washington. The pace of reform may slow, however, as the harder problems, such as product patents, are tackled, and regulations for administering and enforcing these new laws are worked out. Moreover, once the US GSP review is completed, an important US bargaining chip will be removed. In addition, the problem is likely to shift to countries offering less protection. Thailand, for example, has reportedly replaced Taiwan as the primary source of counterfeit goods as a result of Taipei's stiffer laws and enforcement against copyright infringement. 25X1

25X1

Briefs

Energy

Another Inconclusive OPEC Meeting

OPEC adjourned its latest meeting without any formal agreement on production or pricing targets. The members agreed to reconvene in Geneva on 28 July. In the interim, oil ministers will review proposals on individual production quotas with heads of states. The inconclusive meeting probably means that OPEC production will remain high, nonmembers will have little incentive to cut output, and world oil prices will dip below the current average of about $14 per barrel. Oil ministers at least have proposals to take home and this may set the stage for an accord later in the year, when seasonal increases in demand will make agreement easier. Iran indicated some willingness to accept a temporary price target of $17 to $20 per barrel—a concession that could help facilitate a new accord—but substantial differences remain between Tehran and the majority of OPEC members on the issue of production quotas. [redacted]

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Sudan's Oil Dealings

Sudan appears to have secured sufficient petroleum to meet its needs through September 1986 and hopes to obtain at least an additional year's worth from other donors. In late May, Saudi Arabia agreed to supply crude oil in exchange for Sudanese sorghum. The final shipment from the Saudis arrived in June and is expected to last through July. In addition, Libya has promised to cover Sudan's petroleum needs for August and September 1986 in exchange for $27 million worth of beef. [redacted] a Sudanese delegation will travel to Kuwait and Iran to discuss promises to provide Sudan with a one-year supply of oil. Donors have been reluctant to supply Sudan with more than short-term amounts, citing the government's continuing inaction in dealing with its economic problems. [redacted]

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China Increasing Coal Exports

Beijing is planning to triple its coal exports to 30 million metric tons annually by 1990 to help offset losses of foreign exchange from lower oil prices. China announced on Sunday that its coal exports should reach 10 million tons in 1986, a 32-percent increase over exports in 1985. China has developed new markets for coal in South Korea, the Netherlands, and Turkey. Some of the increase will come from China's share of coal from the Sino-US joint-venture coal mine at Pingshuo, which will open next year. Because of lower international coal prices, however, additional exports this year will offset little of the $2 billion China probably will lose in oil exports. Beijing has the resources to meet its goal for 1990, and, if necessary, it will drop its price for coal to develop new markets. [redacted]

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International Finance

Mozambique Preparing for IMF Negotiations

The Mozambican Government has prepared a package of economic reforms designed to induce a favorable response from an IMF team scheduled to visit Maputo on 7 July, according to US Embassy reporting. The package includes a substantial devaluation, reduced budget deficits, credit restrictions, and liberalized price controls. Mozambique wants an IMF agreement to help it recover from a staggering 20-percent economic contraction in 1985 caused by countrywide insurgent activity. An IMF loan also would round out a two-year effort by Maputo to increase its economic ties to Western institutions and to reduce its reliance on socialist economic programs. Although Mozambique is determined to conclude a deal with the IMF, according to Embassy reporting, negotiations probably will be drawn out and the effectiveness of new economic reform measures will depend heavily on the course of the insurgency and the willingness of Western countries to increase aid donations. [redacted] 25X1 25X1

Mexico Suspends Cuban Credit Line

Mexico is holding firm on its April decision to suspend a longstanding credit line to Cuba, according to the US Embassy. The decision apparently was reiterated to Cuban Vice President Rodriguez when he visited Mexico in early June. Mexican officials have stated that the credit line will not be reinstated until Cuba becomes current on its debt payments to Mexico [redacted]. In our view, Mexico City's action resulted primarily from its own financial difficulties. The Mexican administration suspended the credit line when Cuba became delinquent in its payments to BANCOMEX, the government-owned Mexican bank financing the line. The Mexican cutoff most certainly will reverse the current trend toward increased trade between the two countries. Mexico City earlier this year had boosted Cuba's credit line to $150 million to promote Mexican nonpetroleum exports and to finance key Cuban industrial projects. [redacted] 25X1 25X1 25X1 25X1

International Trade

South Korean Counterproposal to US "Standstill" Request

Seoul reportedly plans to offer a counterproposal to the request for an export "standstill" during the next round of US-ROK textile negotiations, now scheduled for early July. [redacted] Nonetheless, Ministry of Trade and Industry officials responsible for the impending renegotiation of the Multi-Fiber Arrangement reportedly have adopted a more hardline attitude. [redacted] 25X1 25X1 25X1 25X1

Global and Regional Developments

Bogota Summit of Latin Coffe[redacted] *Produce*[redacted]

The delegates from Latin America's major coffee producers (Brazil, Colombia, Mexico, and Central America) met in Bogota recently to prepare for the September meeting of the International Coffee Agreement in London, where producers and consumers determine world coffee quotas for the next year. In an unprecedented decision, the producers agreed to back joint Brazilian-Colombian efforts to maintain current high prices in the world coffee market, which was recently affected by speculative buying after Brazil's harvest shortfall early this year. Brazilian Coffee Institute President Graciano maintained that he would not permit any reduction in Brazil's quota, despite recent weather-induced crop losses; he backed the Colombian position that quotas should be based, in part, on stocks held by producer countries. Colombia is the only producer that will have sizable stocks on hand next year, and Colombian Federation of Coffee Growers officials believe these would serve to maintain coffee prices at reasonable levels. All delegates urged continued US adherence to the International Coffee Agreement. [redacted]

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25X1

Angola Paying Oil to Cub[redacted]

Angola has persuaded Cuba to accept 3.5 million barrels of crude oil over the next six months as compensation for Cuban construction projects in Angola, according to the US Interests Section in Havana. Frustration over what it considered unfairly low prices for Angolan oil on world markets apparently induced Luanda to ask Cuba to accept the oil deal. In early June, for example, Angola's state-owned oil company was able to get only $7.50 a barrel for 200,000 barrels of crude oil delivered to European companies, [redacted]. We have no information on whether Cuba agreed to pay world average prices—about $14.30 a barrel—or will credit Angola's account on the basis of what it can get for the oil. At the current world average price, the oil shipments would be worth $50 million, about one-third of Angola's estimated annual bill for nonmilitary services from Cuba. [redacted]

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National Developments

Developed Countries

[redacted] 25X6

Tokyo Debates Changing Aid Policy

[redacted]

The Finance Ministry appears to be effectively derailing recent Foreign Ministry proposals to help developing countries cope with increasingly costly yen-denominated loans extended by the Japanese Government, [redacted] 25X1 25X1 In response to requests from some Southeast Asian debtors who have seen their debt burden increase by 30 to 40 percent as a result of the yen's recent appreciation, the Foreign Ministry wants to provide additional official yen loans at lower interest rates. 25X1 The Finance Ministry, however, refuses to consider such measures because it is intent on reducing the deficit of the Overseas Economic Cooperation Fund (OECF), one of the main governmental overseas lending agencies. The Ministry has agreed instead to permit up to 30 percent of project-related yen loans to go to cover local costs, primarily personnel expenses. Although it was announced that local-cost loans will be extended to Indonesia, [redacted] 25X1 future decisions under this program will be made on a case-by-case basis. [redacted] 25X1

Weak Norwegian Austerity Program [redacted]

The Norwegian parliament's $420 million austerity package falls far short of solving Oslo's fiscal problems because oil tax revenues are expected to decline by at least $2 billion this year and another $3 billion next year. After failing to get a personal income tax increase, the new minority Labor government accepted many proposals from the opposition parties. The resulting package includes spending cuts as well as increased national pension system contributions and higher taxes on gasoline, tobacco, and alcohol. The government did not seek a vote of confidence on any of the items, indicating it wants to stay in office for now. Meanwhile, although the opposition parties cooperated to block many Labor proposals, they do not want to contest Labor's hold on power yet. With Norway facing an economic slowdown and the prospect of rising unemployment, the opposition will hope that discontent with the Labor government grows. More intense confrontation on economic issues is likely to occur after parliament resumes in the fall. [redacted] 25X1 25X1

Israeli Nurses' Strike Continu [redacted]

The Israeli hospital nurses' strike—involving approximately 13,000 nurses nationwide—is in its second week, with no prospects for an early settlement. The nurses are demanding negotiations with the government on all outstanding issues, particularly salary. The government has agreed to discuss employment conditions, but has stated that salary issues can only be handled in the broader context of the ongoing public-sector wage negotiations. Hospitals currently are functioning with skeleton staffs in emergency rooms, maternity wards, and intensive care units. The nurses, however, have threatened to walk off the job entirely if the government refuses to move quickly on the wage issue. [redacted] 25X1 25X1

Less Developed Countries

Challenge to Brazil's Nuclear Energy Commission [redacted]

A presidential blue ribbon panel, which reviewed all of the nation's nuclear programs, recommended replacing the Nuclear Policy Commission with two separate new entities to direct research and licensing, respectively. [redacted] 25X1 25X1

[redacted] The proposed revamping of the nuclear bureaucracy probaby exceeded President Sarney's expectations. The panel did, however, endorse one of his concerns, the undesirability of continued dependence on West Germany, which has provided comprehensive, safeguarded fuel-cycle technology since 1975. Sarney, who has expressed no dissatisfaction with the nuclear commission, probably will maintain its present structure and its leadership. This will prove reassuring to nuclear proponents in the military and in the National Security Council, influential constituencies that fund and direct critical projects in the unsafeguarded national nuclear program. [redacted] 25X1 25X1 25X1

Iran Searching for Foreign Exchange

Lower oil prices are pushing Tehran to try to collect some of the $2.5 billion tied up in disputes with the United States and France. Iran is seeking to expedite unresolved cases before the Iran-US Claims Tribunal, created in 1981 to settle bilateral commercial disputes. The National Iranian Oil Company may try to reach settlements with US claimants outside the Tribunal in two cases. [redacted] Iranian 25X1 Central Bank officials have discussed outstanding US corporate and bank claims with US bankers. Tehran also has recently intensified efforts to obtain repayment of a $1 billion loan to France by the Shah. Tehran had previously insisted that all unresolved claims—estimated at about 2,000, including several large claims involving US oil companies—be settled individually; it probably will be more willing to expedite claims now, but quick settlements remain unlikely. 25X1 Iran has about $3 billion in readily accessible foreign exchange reserves but would like to free funds tied up in litigation—about $1 billion—to limit import reductions. [redacted] 25X1

India's Export Incentives

New Delhi is preparing a package of income tax relief measures designed to boost exports, according to US Embassy reporting. The measures are expected to be submitted for parliamentary approval this summer. India's exports declined last year and its trade deficit exceeded $6 billion. India's five-year development plan calls for 6.8-percent average growth in export volume during FY 1986, but this is the first major attempt by the government to stimulate exports. 25X1 The proposed measures include special tax credits for foreign exchange earnings and a 50-percent tax credit for export profits. The US Government believes the export incentives may include subsidies that would violate GATT codes and open India to countervailing duty action by trading partners. Indian officials, however, insist that the program is within the GATT subsidies code. [redacted] 25X1

New Indonesian Financing Concerns

[redacted] 25X1

[redacted]

Indonesia's bleak economic outlook is forcing Jakarta to increase its already deep budget cuts, [redacted] the government is now cutting 25X1 back on official overseas travel and delaying the disbursement of development funds. Jakarta, [redacted] would have to draw down its foreign 25X1 reserves—currently estimated at nearly $11 billion—by at least $4 billion this year to make up for the shortfall in foreign capital inflows. In our view, however, any significant drawdown in reserves could seriously threaten the credit standing of Indonesia because its international bankers have become accustomed to large annual increases in reserve holdings. In addition, a dramatic drawdown of reserves could lead bankers to curtail credit lines, precipitating a rescheduling of its foreign debt. In any event, Jakarta's economic situation will not become critical, in our judgment, unless the price of Indonesian crude oil—currently about $11.50 per barrel—softens further. [redacted] 25X1

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Communist

Soviet Grain Imports Tumble

Estimated Soviet grain purchases of almost 31 million metric tons during the marketing year that ended 30 June were at a five-year low and a marked reduction from the record 54 million tons purchased in the 1984/85 marketing year. Improved domestic crop production and lower market grain prices helped cut the hard currency grain import bill by an estimated $3 billion to about $3.5 billion. These savings were partially offset, however, by a more than doubling 25X1 of soybean imports, a possible reflection of plans to improve the mix of livestock feeds. Heavy Soviet buying of US soybeans—1.5 million tons over the past year—contrasted sharply with Moscow's activity in US wheat markets, where reduced Soviet demand and high US prices limited purchases to only 153,000 tons. Despite some probable small wheat purchases, the overall pace of Soviet grain buying shows little sign of picking up as continued favorable crop production forecasts and hard currency constraints will probably limit grain imports in the near term. 25X1

New Soviet Guidelines for Higher Education

Moscow recently published draft guidelines to make higher education more responsive to requirements for critical technical skills to support the industrial modernization program. The new guidelines call for a system of contractual relationships between higher educational institutions and enterprises—the institutions will supply graduates in needed specialties in return for funding to upgrade educational facilities and equipment. Higher educational institutions 25X1 are to make their research more relevant to the needs of industry, cut down on the proliferation of specialties, and emphasize a broad general scientific background that will enable students to better adapt to changing technology. Students are to spend more time in independent work and practical training in new "educational-scientific-production complexes" and regional training centers sponsored by enterprises. To address the serious problem of underemployment of skilled labor—currently one-half of college-educated specialists are in jobs that do not utilize their skills—secondary schools are to graduate more midlevel technicians, while standards for admission to higher schools will be raised for engineering and other technical specialties. There will be higher wages for the relatively low-paid engineering profession as well as more pay differentiation according to the quality of work and the complexity of the job. The new program for restructuring higher education is the latest in a series of measures aimed at alleviating the shortage of skilled labor. Success will depend on whether the new system of contract relationships provides enterprises with a real incentive to increase their investment in the educational process as well as on whether the enterprises will have the funds to invest.

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Czechoslovakia Forms First Joint Venture

Czechoslovakia has agreed to form its first joint venture with a Western company in a test of the feasibility of direct foreign investment. The new entity will produce measuring equipment and will involve a modest $2 million investment by the Danish partner Senetec. The Czechoslovaks are also nearing agreement on a large joint venture with the Dutch firm Philips to produce compact disk players, and have been in touch with the Japanese firms Toshiba and JVC. Complicated legal arrangements and a resultant uncertainty over 25X1 the rights of Western partners have hampered formation of these experimental joint ventures. Reservations by hardline elements in the leadership have also been an inhibiting factor, although increasing Soviet interest in joint ventures may help reassure them. If successful, the experimental joint ventures could give a boost to the Czechoslovak electronics industry—a key sector in leading industrial modernization under Prague's 1986-90 Five-Year Plan—and lead to more extensive joint venture formation in the future. [redacted] 25X1

China To Increase Nonferrous Metals Exports

The Chinese apparently plan to increase exports of selected nonferrous metals, including tungsten and tin, and use the earnings to purchase technology for China's copper and aluminum industries. Chinese purchases of copper and aluminum are a major drain on Beijing's foreign currency reserves; we estimate that imports of these metals reached nearly $1 billion in 1985. China—with small copper reserves—wants to upgrade domestic production to reduce imports. On the other hand, China's rich bauxite deposits may support enough growth in its aluminum industry to make China an exporter by 1990. [redacted] 25X1 25X1

Chinese Plan Dairy Expansion

[redacted] 25X1

China plans to increase its dairy herd from the current 1.3 million head to 8 million head by the year 2000. The Chinese stated that they were focusing on US breeding stock, and have already purchased several hundred US dairy cattle this year. However, China is purchasing even more dairy cattle from Western Europe, and, [redacted] will continue to do so be- 25X1 cause of EC subsidies for medium-quality breeding cattle. [redacted] 25X1 the Chinese plan to purchase some high-quality dairy cattle from US 25X1 breeders to improve herd quality, but would purchase more if prices were more 25X1 competitive with EC cattle. [redacted] 25X1

Beijing Reaffirms Emphasis on Science and Technology

Ranking government and party officials reassured scientists of their support for S&T reform at the Chinese Association for Science and Technology (CAST) Congress last week. Hu Qili, member of the Politburo and Central Committee Secretariat, urged more support for S&T management reforms to increase the contribution of S&T to economic development. Furthermore, Hu endorsed the concept of greater academic freedom, a key concern among China's scientific community; the assembly later adopted this principle as part 25X1
of the CAST constitution. Song Jian, State Councilor and Minister of the State Science and Technology Commission, also noted that laws are being drafted to protect scientists from outside interference. Although many scientists have reacted enthusiastically to incentives to work closely with industry, for others there is confusion over what is permitted, concern that political support for the changes would lessen, and fear that their own power or prestige would decrease. Beijing probably hopes that the high-level show of support, aimed at an organization with 6.7 million members, will prompt the footdraggers to more speedily carry out the reforms. 25X1

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